

505   **Q.    Please describe the legislative and regulatory background leading to the decision to**  
506   **conduct a competitive auction to procure Basic Generation Service in New Jersey.**

507   **A.**    Certainly. In January 1999, the New Jersey legislature passed the Electric Discount and  
508   Energy Competition Act ("EDECA" or "the Act"), which was signed into law on  
509   February 9, 1999. EDECA provided that all New Jersey retail electric customers could  
510   select their electric supplier starting on August 1, 1999. EDECA also established Basic  
511   Generation Service ("BGS") as a regulated service designed to provide electricity to  
512   customers who, for whatever reason, did not arrange to purchase electric supply from a  
513   competitive entity. (In New Jersey, competitive entities offering unregulated retail  
514   generation service are referred to as Third Party Suppliers or TPSs.) EDECA established  
515   a transition period lasting four years and starting on August 1, 1999. During the  
516   transition period, BGS rates were frozen. EDECA provided that, after the transition, BGS  
517   rates were to be market-priced.

518           For the first three years of the transition, each Electric Distribution Company  
519   ("EDC") was required to continue to provide BGS to its customers. The EDCs all settled  
520   on restructuring plans that involved divesting generation through asset sales to an  
521   unrelated entity or through transfers to an unregulated affiliate. The retail rates for BGS  
522   were fixed for all four years to realize the electric discounts specified in EDECA. The  
523   four EDCs used a variety of means to supply BGS customers during the first three years,  
524   ranging from a full-requirements contract with an affiliate that owned transferred  
525   generation capacity, to a variety of market purchases of energy, capacity and other  
526   hedging instruments. The EDCs that relied on market purchases built up substantial  
527   deferred accounts that represented the excess of power acquisition costs over revenues

528 from the fixed BGS rates. The EDCs were entitled to recovery of these deferred amounts  
529 under the terms of the relevant settlements.

530 EDECA specified that no later than three years after the starting date of retail  
531 competition, the BPU was to issue a decision as to whether to make available to electric  
532 suppliers the opportunity to provide Basic Generation Service on a competitive basis.  
533 EDECA and the settlements reached by the EDCs in their restructuring cases  
534 contemplated that a competitive bid process would potentially be used to select BGS  
535 suppliers.

536 On June 6, 2001, the BPU directed the four EDCs to file specific proposals to  
537 implement a competitive procurement process for basic generation service to be provided  
538 during the fourth year of the transition period established by the Act. The fourth year of  
539 the transition was from August 1, 2002 to July 31, 2003.

540 On June 29, 2001, the four EDCs filed a joint proposal to use a single statewide  
541 auction process to procure supply for the BGS load of all four EDCs. That proposal was  
542 the subject of substantial discovery and other parties were invited to comment on the  
543 EDCs' proposal and submit alternative proposals. After conducting a hearing and  
544 reviewing comments from all interested parties, the BPU in December of 2001 approved  
545 the single statewide auction process for BGS to be held in February of 2002. As retail  
546 BGS rates were fixed for the fourth year of the transition period, there was a need to  
547 establish the market price for BGS for that year in isolation so that any difference  
548 between that year's costs and fixed rates could be deferred for later reconciliation. The  
549 supply period was only one year.

550           In June or July of each succeeding year, the EDCs have filed a proposal to  
551           procure supply for their BGS customers in compliance with the BPU's directives. Each  
552           year, the EDCs have proposed a statewide auction process to simultaneously procure  
553           supply for all BGS load in the state. Each year, the BPU has requested alternate  
554           proposals from other parties, or suggestions on improvements to the past year's process.  
555           Discovery has been served every year, and every year the BPU solicits comments from  
556           all interested parties, and the BPU holds a hearing process. Considering the entire record  
557           in the proceeding, the BPU then has made a decision in November or December of each  
558           year. The BPU has authorized each year a statewide auction to be held in February.

559   **Q.    After the first year, how has the auction process changed?**

560   A.    One major difference in the auction process that has occurred since 2002 is that starting  
561           in February 2003, there have been two auctions instead of one.

562           One auction is to procure supply for all but the larger commercial and industrial  
563           customers. The supply period for this auction (the BGS-FP auction, "FP" for fixed-price)  
564           is three years. The procurement is made on a rolling basis so that one-third of the state's  
565           BGS-FP load is up for auction each year.

566           The other auction, (the BGS-CIEP auction, CIEP for Commercial and Industrial  
567           Pricing) is to procure supply for the larger commercial and industrial customers. CIEP  
568           service is a real time energy price service. The supply period for this auction is one year.

569           Another major difference with the first auction is that starting with the second  
570           auction, the results of the BGS auctions are the basis for establishing retail BGS rates.  
571           This is because the retail rates were frozen in the first year. But, as discussed above, the

572 difference between the frozen rates and the BGS acquisition cost was to be deferred for  
573 later recovery or refund.

574 **III.B. The Goals of the New Jersey BGS Auctions**

575 **Q. What is your understanding of the goals of the statewide auction process in New**  
576 **Jersey?**

577 **A.** Based on my involvement in the design and implementation of the BGS auction process,  
578 I believe that the EDCs had the following goals for the auction proposal that they offered:

- 579 1) **To obtain reliable supply on behalf of BGS customers at prices consistent**  
580 **with market conditions.** EDECA specified that the prices charged for the  
581 regulated BGS service should reflect the market. The EDCs were interested in  
582 implementing an auction process that resulted in prices reflective of market  
583 conditions.
- 584 2) **To encourage maximum participation by establishing a fair and transparent**  
585 **competitive process.** The process should be transparent in terms of the  
586 requirements for participation, the supply contract, the retail rates that will result  
587 from the auction, and the manner in which final auction prices are determined and  
588 the manner in which winners emerge at the auction. The process should be fair in  
589 terms of providing timely and equal access to information for all bidders.
- 590 3) **To efficiently allocate supply responsibility over the multiple products in the**  
591 **auction.** An efficient allocation of supply helps to ensure that prices are best  
592 reflective of market and that any market perceptions regarding differences in  
593 serving various products are reflected in the prices.

- 594           4)   **To have competitive entities take, manage, and price BGS risks.** BGS is  
595                   essentially a price-risk management service where competitive entities assemble  
596                   supply components in the competitive wholesale market, assess risks, price these  
597                   risks, and offer a fixed price to customers. Regulation is not needed for a service  
598                   (portfolio and price-risk management) where there is vigorous competitive  
599                   discipline, and having competitive entities manage BGS risks ensures that  
600                   customers obtain the full benefits of this competition for the price-risk  
601                   management function.
- 602           5)   **To implement a process for BGS pricing that encouraged the development of**  
603                   **and efficient working of retail energy markets.** This means pricing BGS at  
604                   market rates in order to encourage the development of efficient retail competition.  
605                   BGS rates should reflect class, seasonal and time-of-day market differences in  
606                   order to encourage efficient consumption and conservation decisions, and in order  
607                   to minimize non-productive customer switching in response to rate design  
608                   inefficiencies.
- 609           6)   **To design a flexible process.** A flexible process is one that can accommodate  
610                   future refinements without radical overhaul.
- 611           7)   **To minimize customer confusion.** The procurement of BGS should, to the  
612                   extent possible, present customers who stay on EDC service with the same type of  
613                   retail rate and billing that they had experienced previously.
- 614           8)   **To preserve the financial integrity of the EDCs.** BGS costs and revenues can  
615                   exceed 50% of total EDC cost and revenue. BGS costs are an order of magnitude  
616                   greater than EDC earnings. The EDCs earn no profit from BGS and could not

617                   afford to take risk. It was imperative that the BGS process protect the financial  
618                   integrity of the EDCs.

619   **Q.     Why are the goals of the New Jersey process relevant to this proceeding?**

620   A.     The New Jersey process is an example of an auction process to procure supply for default  
621           customers that is working well and is considered a success by the regulator, by the  
622           distribution companies and by bidders. It is necessary to examine and understand the  
623           goals of the process to understand how the process was designed and how all elements of  
624           the process work together. All features of the proposal were designed to work in concert  
625           with each other and to support the goals of the process.

626   **III.C. The Key Elements of an Auction Process**

627   **Q.     Is it correct that one of the items that you were asked to prepare testimony on was a**  
628           **description of the key elements of the New Jersey BGS auction process?**

629   A.     Yes.

630   **Q.     What in your opinion are the key elements of the New Jersey BGS auction process?**

631   A.     I believe that there are eight key elements to any auction process that will be used to  
632           procure electric service that will be supplied to retail electric customers. These elements  
633           are summarized below.

634         1)    **Product design.** The product design fully describes what is being procured at the  
635                auction. It includes a description of the obligations of the supplier upon winning,  
636                the allocation of risks to the supplier, the term of supply, the customers and load  
637                classes to be supplied, *etc.* Ultimately, product design should be fully described  
638                in the supplier contract.

- 639           2)     **Auction format.** The auction format is the way in which bids will be solicited  
640                     and accepted, the way in which bids will be processed, the way a clearing price  
641                     will be determined, and the way in which winners will emerge.
- 642           3)     **Bidder interface.** The bidder interface is the way in which bidders are provided  
643                     with information about the auction process, the way in which data is  
644                     disseminated, and the way in which the auction opportunity is promoted.
- 645           4)     **Qualification requirements.** These are the procedures for qualifying bidders to  
646                     participate in the auction.
- 647           5)     **Rate Design.** The rate design parameters specify how the auction results will be  
648                     translated into retail rates.
- 649           6)     **Competitive safeguards.** These are the procedures and features of the auction  
650                     process that promote competition at the auction.
- 651           7)     **Regulatory Involvement.** This describes the role played by the regulator and  
652                     other parties in the process.
- 653           8)     **Cost recovery assurances.** This is a description of the assurances sought from  
654                     the regulator with respect to cost recovery for supply arranged through the  
655                     auction.

#### 656     **III.D. The Key Decision on the Elements of the New Jersey Process**

657     **Q.**     Are you able to describe the decisions were made with respect to these elements for  
658                     the New Jersey Auction Process and how was each of these decisions important to  
659                     the success of the auction process?

660     A.     Yes.

661 **Q. Please address the decisions made with respect to the first element, the product**  
 662 **design, as it relates to the BGS-FP Auction.**

663 A. With respect to the product design, several key decisions were made.

664 The first decision was to have winning suppliers provide full-requirements  
 665 service. This meant that the BGS suppliers would supply all components of BGS supply,  
 666 including capacity, energy, transmission, and ancillary services. BGS suppliers would  
 667 fulfill wholesale market credit requirements, and would take, manage, and price, all  
 668 volume risks including those from weather and customer migration. In return for  
 669 supplying full-requirements service, suppliers would be paid for each kWh of BGS  
 670 energy delivered to the wholesale meter. Suppliers would be paid as a function of the  
 671 auction price, being paid the auction price times a summer factor reflecting higher  
 672 summer costs from June to September (*e.g.*, the summer factor is greater than one and,  
 673 for example, might be 1.2) and the suppliers would be paid the auction price times a  
 674 winter factor reflecting lower winter costs for the remaining months (*e.g.*, the winter  
 675 factor is less than one and, for example, might be 0.9).

676 **Q. How did the decision to have winning suppliers provide full-requirements support**  
 677 **the goals of the BGS procurement process?**

678 A. The decision for the product to be full-requirements supply supported many of the goals  
 679 of the process. The full-requirements product directly contributes to fulfilling the goal of  
 680 having competitive entities take, manage and price BGS risks. The full-requirements  
 681 product places risk management responsibility in the hands of competitive entities that  
 682 were best suited to take, manage, and price these risks. This would ensure that customers'  
 683 prices are disciplined by competitive forces. This also would help assure that these



services can be provided as efficiently as possible, i.e., with each supplier free to hedge or meet requirements in any way that it chose, rather than being limited by regulatory review.

The full-requirements product contributes to the goal of maximizing participation in the process. It expands the base of potential competitors, including financial players and marketers and traders without an asset base in the region. Those entities are able to use specialized skills in price-risk management to assemble wholesale portfolios and compete in the auction. Resp. Exs. 6.3 and 6.4 to this testimony summarize the participation in the auction and document the fact that participation has not been limited to portfolio owners in the regions, but has instead included a broad base of suppliers, including marketers and traders, and financial players.

A full-requirements product also avoids customer confusion by obtaining a market-priced fixed price service for customers so that customers can reasonably budget for energy usage. The full-requirements product also contributes to the goal of encouraging efficient retail markets. The price against which customers will evaluate competitive offers, the BGS price, is established and known in advance. Furthermore, it is set at a market level that includes all wholesale supply costs and risks.

**Q. Was there another decision with respect to the first key element, product design, that you believe was important?**

A. Yes. A second important decision was to determine the BGS supplier responsibility on the basis of "tranches", where each tranche represents a fixed percentage of the total BGS load requirement for an EDC. The percentage of BGS load corresponding to one tranche was chosen so that one tranche would be about 100 MW of peak load assuming normal

707 conditions and no migration. A supplier then bids to win a certain number of tranches,  
708 which translates to a set percentage of the total BGS load requirement.

709 **Q. How did defining the supplier responsibility on the basis of tranches contribute to**  
710 **the goals?**

711 A. The decision for suppliers to be responsible for a percentage of the BGS load  
712 requirements (and thus to be responsible for a percentage of the requirements for all  
713 customers) supported the goals of the process in the following ways.

714 This decision avoided customer confusion. Customers are not assigned to a BSG  
715 supplier, but continue to maintain a commercial relationship for BGS with the EDC.  
716 Customers are informed that a variety of suppliers are responsible for BGS supply, but  
717 are not switched to another supplier. In the New Jersey context, where there was  
718 considerable backlash over "slamming" in the context of telephone deregulation, this is  
719 an important consideration. This decision contributed to maximizing participation.  
720 Potential suppliers did not have to establish the infrastructure necessary to establish a  
721 retail relationship with customers, and did not have to take collection risk. Requiring a  
722 retail relationship would have limited the ability of some market players to participate in  
723 the auction.

724 **Q. Were there other decisions with respect to the first key element, product design, that**  
725 **you believe were important?**

726 A. Yes. Two more major decisions that were made. One decision was to have a standard  
727 supplier contract used statewide. During the regulatory review of the Auction Process,  
728 suppliers have an opportunity to comment on the contract and the BPU makes the final  
729 decision on contract terms. After the BPU has made its decision, the contract terms are

730 non-negotiable. The prospective bidders must accept the contract terms before they are  
 731 qualified for the auction. Another decision was to procure the load on a rolling three-year  
 732 basis.

733 **Q. How did having a standard supplier contract and a rolling procurement structure**  
 734 **further the goals of the process?**

735 A. The standard contract served to further several of the goals of the process. The use of a  
 736 standard contract promotes the transparency of the process and encourages participation.  
 737 All bidders know the terms under which supply will be provided because the terms are  
 738 standardized and are set forth in an agreement that is made available in advance of the  
 739 auction. Given that all prospective bidders accept these terms before the auction, and  
 740 given that, as we will explain below, all prospective bidders are required to meet the  
 741 same standard qualification requirements, bids can be compared strictly on a price basis.  
 742 The determination of the final price and of the winners at the auction then can be made in  
 743 a transparent way through the auction format, also discussed below. A standard contract  
 744 is also an essential item for ensuring fairness and for maximizing participation in the  
 745 auction.

746 A rolling procurement structure promotes the goal of providing prices for  
 747 customers that are reflective of market, while not exposing smaller customers to the  
 748 possible volatility of short-term market fluctuations.

749 **Q. Can you please describe the decisions that were made with respect to the second key**  
 750 **element, the auction format?**

751 A. Yes. In New Jersey, a clock auction format was selected. The clock auction format is a  
 752 multiple round, open, and simultaneous auction.

753           The clock auction used in New Jersey can be described as follows. The BGS load  
754 of each EDC for a given term is a product in the auction. In round 1 of the auction, the  
755 Auction Manager announces a price for each product in the auction. Bidders bid by  
756 specifying the number of tranches they are willing for each product at the prices for  
757 round 1. After the first round of bidding, the Auction Manager tabulates the bids from all  
758 bidders, calculating the amount of supply bid for each product. If there are more tranches  
759 bid than are needed for a product, the Auction Manager will tick down the price for that  
760 product in the next round. The Auction Manager announces the prices for the next round  
761 to the bidders, along with an indication of the excess supply in the auction. Bidders are  
762 given time to consider this information, and then the next round begins. In the next and  
763 subsequent rounds, bidders bid at the new prices announced by the Auction Manager.  
764 Bidders state how many tranches of each product that they wish to supply at that round's  
765 prices. Bidders may, in response to the new prices in the round, reduce the number of  
766 tranches that they are bidding in total across all products. If a bidder reduces the number  
767 of tranches that the bidder wishes to bid in total, the bidder provides an exit price, which  
768 is the last and best offer on the tranches being withdrawn from the auction. (Bidders,  
769 however, can never increase the total number of tranches across all products.) Bidders  
770 also may switch their bids from one product to another product. Bidders switch by  
771 reducing the tranches bid on one product while increasing the number of tranches bid on  
772 another.

773           The auction rules are designed to ensure that, if at any time during the auction, the  
774 loads of all products are fully subscribed (*i.e.*, for each product there are sufficient bids to  
775 serve its load), then the load of all products will be fully subscribed at the end of the

776 auction. There are specific rules that ensure that this is the case. First, if the price for a  
777 product does not change from one round to the next, bidders cannot rescind their offers  
778 by reducing the number of tranches bid for that product. Bids at a price are firm offers to  
779 supply. If the price does not change, the offer must be held. Second, if the price for a  
780 product does change and a bidder requests to switch out of a product or to reduce its  
781 number of tranches bid, and if that request would result in a product being  
782 undersubscribed, then the request can be denied. If a request to switch out or to withdraw  
783 tranches is denied, enough tranches are retained to ensure that the products are fully  
784 subscribed. The tranches are retained at the price at which the bidder is willing to bid  
785 them (either an exit price if the tranche is withdrawn, or the last price at which the  
786 tranche was bid if the bidder had requested a switch).

787 The auction ends when the total number of tranches bid equals the number of  
788 tranches being purchased. The bidders with bids remaining at the end of the auction are  
789 the winning bidders because they were willing to bid at the lowest prices.

790 A detailed set of rules comprising dozens of pages sets forth the procedures.

791 **Q. How does the auction format, the second key element, work to advance the goals of**  
792 **the process?**

793 **A.** The auction format chosen furthers several goals.

794 The clock auction format is transparent and maximizes participation. Bidders can  
795 clearly understand how the final auction price is determined and how winning bidders  
796 emerge. The fact that the format does not advantage established players can encourage  
797 smaller, newer or non-affiliated bidders to participate.

798           The clock auction format is an open auction. As I explained above, I believe that  
799           this kind of auction format decreases the uncertainty faced by bidders. As an auction  
800           format that provides feedback to bidders as to the common view of the market, this  
801           auction format is an effective means of eliciting the best bids when all bidders are  
802           evaluating a common market opportunity, as is the case for BGS load. By seeing how  
803           other bidders in the aggregate are responding, an individual bidder can adjust its bidding  
804           strategy and may well be willing to better its offer while it would not have had that  
805           opportunity in a sealed bid process. This auction format is particularly well suited to  
806           obtaining prices consistent with the market.

807           The clock auction is a simultaneous auction. As I explained above, I believe that  
808           procurement of different products simultaneously in a single auction process leads to the  
809           efficient allocation of the supply responsibility over these different products. As bidders  
810           can observe prices and revise their bids, those that can most efficiently supply a product  
811           will be more likely to win tranches of that product.

812           The clock auction is inherently a flexible auction format. It can accommodate, in  
813           one simultaneous auction, products of different terms, products for different EDCs, or  
814           products for different customers segments. The clock auction is an essential element of  
815           preserving the flexibility of the process and of accommodating future refinements.

816           The clock auction also helps ensure that all products are subscribed, even if there  
817           are several small products that may not have attracted as much interest on their own. In  
818           the clock auction format, all products can be put at auction at once so that the broadest  
819           range of interest is attracted to the auction, and invited to bid even on smaller products.

820 As the price tick down, if a smaller product's price remains high for a time, it will attract  
821 bids and its price too will tick down.

822 **Q. Are there aspects of the auction format that you believe are particularly important**  
823 **in contributing to the success of the BGS auction?**

824 A. Yes. Of all these ways in which the auction format contributes to the success of the  
825 auction process, I believe the main strengths of the clock auction in the context of the  
826 New Jersey BGS auctions are the following. First, the clock auction provides feedback  
827 and information to bidders, which encourages the best bids. Second, the transparency of  
828 the process encourages high participation and competitive prices. Finally, the format  
829 allows for multiple products to be procured simultaneously leading to prices that are  
830 reflective of market conditions.

831 **Q. Please describe the decisions made in the New Jersey BGS Auction with respect to**  
832 **third key element, the bidder interface.**

833 A. With respect to the third element, the Bidder Interface, the decision was made that the  
834 Auction Manager would be the clearinghouse for all bidder inquiries, information  
835 requests, and comments. The Auction Manager would provide timely and fair access to  
836 information for all bidders.

837 More specifically, the Auction Manager establishes a web site and obtains from  
838 the EDCs the data and documents required by bidders to assess the auction opportunity.  
839 The Auction Manager conducts bidder information sessions to promote the auction. The  
840 Auction Manager informs potential bidders of regulatory developments. The Auction  
841 Manager assists with understanding application requirements and bidding procedures.  
842 Finally, the Auction Manager responds to all bidder queries. The EDCs do not directly

respond to any bidder inquiries and instead refer all questions and comments to the Auction Manager. The Auction Manager may require the assistance of EDC personnel to respond to some of the inquiries if, for example, a bidder inquiry could relate to the method used to obtain data posted to the web site. Even if this is the case, the Auction Manager obtains a response from the EDC and relays this response to the bidder.

**Q. How does this help to achieve the goals of the process?**

A. Having the Auction Manager provide the bidder interface promotes the fairness of the process. All potential bidders receive identical treatment, which helps to encourage maximum participation and ensures that incumbents or bidders affiliated with the EDCs do not receive any real or perceived advantage.

The Auction Manager, in providing the bidder interface, evaluates the information provided and assesses the needs and information requirements of bidders. The Auction Manager strives ensure that for all necessary information to be provided. This should decrease uncertainty for bidders and encourage the best bids.

**Q. You mentioned qualification requirements as a fourth key element of the process. Please describe those qualification requirements in the context of the New Jersey BGS auction and explain how they help meet the goals of that process.**

A. With respect to the fourth element, qualification requirements, several key decisions were made.

First, all applicants are required to accept the terms of the standard contract and the auction rules. Bidders cannot qualify for the auction without having accepted those governing documents. This decision furthers the goal of having a fair and transparent process.



866           Second, the qualification requirements ensure that, should the bidder come to win  
867 at the auction, it will be able to meet all the requirements of the supply contract. To the  
868 extent possible, the bidder is asked to show that it already meets, or that it will be able to  
869 meet by the start of the supply period, any requirement imposed by the contract (*e.g.*,  
870 credit requirements and licensing requirements.) This decision furthers the goal of having  
871 a fair process and of maximizing participation. I believe that these requirements are  
872 essential to allow all bidders to participate on an equal basis and to enable a price-driven  
873 comparison of the bids. This also permits a rapid execution of supply contracts, thereby  
874 reducing any option premium, and ensuring that the auction produces the best bids.

875           Third, the application process is in two parts. This allows a list of bidders to be  
876 established (after Part 1) so that each bidder can certify that it does not have any  
877 agreement with another bidder that would harm the competitiveness of the auction. This  
878 decision works hand in hand with the competitive safeguards presented below and  
879 ensures that the auction is competitive.

880   **Q.   Please discuss the fifth key element of the BGS Auction Process, which is Rate**  
881   **Design and describe how decisions made in that regard further the goals of that**  
882   **process.**

883   **A.**   The New Jersey auction process has a pre-established rate design methodology. The New  
884   Jersey EDCs file, and the BPU approves, formulae for converting the auction prices to  
885   retail BGS rates. Hence, for any auction clearing price, the retail rates that will prevail  
886   for BGS service are known.

887           This serves several important goals. First, it elicits the best possible bids by  
888   enabling bidders to reasonably evaluate the potential for migration and to make bids that

reflect an analysis of this risk. Second, it contributes to the development of efficient energy markets by ensuring that retail prices reflect auction results and thereby the market.

The specific rate design methodology used in New Jersey translates auction prices into retail rates that are seasonal and sometimes vary by time of day. This specific feature further contributes to the goals by encouraging efficient consumption and conservation decisions. An additional benefit is that by shaping prices seasonally, the incentive to game the BGS offering by seasonal switching is substantially reduced. This helps to limit customer confusion as it reduces the need for switching restrictions.

**Q. What did you identify as the sixth key element of the New Jersey BGS Auction Process?**

A. The sixth key element is competitive safeguards. As I have been asked to specifically prepare testimony on competitive safeguards I will describe these in more detail later. Competitive safeguards contribute to the goal of attracting maximum participation by ensuring that the auction will be fair to all, and to the goal of obtaining supply at competitive prices.

**Q. You identified Regulatory Involvement as the seventh key element of the New Jersey BGS Auction Process. How is the New Jersey BPU involved and how does that involvement support the BGS Auction Process?**

A. The BPU is intimately involved in the process in New Jersey. Regulatory involvement helps to attract maximum interest in the auction, as well as to help to provide assurances of cost recovery, which enable suppliers to offer the lowest price consistent with market

911 conditions. I will address this topic later when I discuss the role of the various entities  
912 involved in the process.

913 **Q. The eighth and final key element of the New Jersey BGS Auction Process is Cost**  
914 **Recovery Assurances. Please explain these and describe why are they are a**  
915 **necessary part of the New Jersey BGS Auction Process.**

916 A. In New Jersey, the BPU approves the formulas that will be used to develop retail rates at  
917 the time it approves the Auction Process. At the same time, the BPU also approves a  
918 reconciliation clause that ensures that revenues billed to BGS customers will equal  
919 payments made to BGS suppliers. The approval of the Auction Process and the auction  
920 results constitute a finding of prudence. The BPU also approves as prudent the  
921 contingency plans of each EDC. In accepting the Auction Results the BPU approves the  
922 specific rates that come from implementation of the approved formulas.

923 The EDCs still have the responsibility to prudently administer the contracts and  
924 any contingency plan purchases, but the *a priori* rate design and prudence determinations  
925 provide substantial assurance of cost recovery. This furthers the goal of maintaining  
926 financial integrity of the EDCs. Further, this helps to obtain lower prices in the auction  
927 as it provides assurance that the EDCs will be able to perform under the supplier contract.

928 **Q. Do you believe that the New Jersey auction process has successfully met its goals?**

929 A. Yes. The auctions have all been successful at procuring the full volume. Each auction  
930 has attracted more interest and the auctions have become increasingly competitive. The  
931 auctions have demonstrated that there are many entities able and eager to assemble  
932 products in the competitive wholesale market and provide price-risk management  
933 services. The winners include generation assets owners, energy trading and marketing

firms, and major financial players. The auctions have demonstrated that the market is competitive and that the process works. *See* Resp. Exs. 6.5 and 6.6 to this testimony for a description of the results of the New Jersey BGS auctions.

**IV. COMPETITIVE SAFEGUARDS**

**Q. What is a "competitive safeguard"?**

A. By a competitive safeguard, I mean an element of the auction process that limits the scope for anti-competitive behavior. Putting in place competitive safeguards serves the goal of maximizing the competitiveness of the auction, and of obtaining supply for customers at prices that are consistent with market conditions.

**Q. In describing the elements of the New Jersey BGS auction process – and the process that Ameren is proposing in Illinois – you have noted that many elements of the process serve to maximize participation and promote maximum competition in the auction. If those elements are in place and the process is designed to elicit maximum participation, why are competitive safeguards needed?**

A. Competitive safeguards are needed for two reasons.

First, competitive safeguards serve as a prudent safety net. The auction process is designed to elicit the best participation in the process. But the participation that in fact comes forward may not be sufficient to allow competitive forces to set the auction prices. While the process can be designed to promote competition, there may be market events, changes in the sector, or crises in the industry that negatively affect participation temporarily. Good planning requires that this contingency be examined and that a measure be ready and in place to ensure that the auction design promotes a competitive result even when participation is less than was desired or anticipated.

957           Second, there is a profit motive to behaving anti-competitively in any market. All  
958           markets have guidelines or rules to ensure that participants are behaving independently of  
959           each other and that competition is fair. Wholesale energy markets sometimes have  
960           bidding restrictions and other rules in place to ensure competitive outcomes. More  
961           generally, other laws and regulations are in place to protect competition. For example,  
962           antitrust laws are in place to ensure that market participants do not abuse their market  
963           position or collude.

964           The auction is a market on a smaller scale. The auction has its own guidelines and  
965           rules to ensure a competitive and fair bidding environment. Violations of some of these  
966           rules might also be violation of antitrust laws. For example, if two entities that had  
967           registered to bid independently in the auction in fact coordinate their bids, those entities  
968           would be violating specific rules of the auction and would be violating their undertakings  
969           in the application process. They might also be violating laws against bid-rigging. Even  
970           if some of the rules were redundant in the sense that to violate an auction rule would also  
971           mean violating an antitrust, these rules of the auction would still serve as a focused  
972           reminder to auction participants of requirements for competitive behavior.

973   **Q.   You mentioned that wholesale markets typically have rules to discourage anti-**  
974   **competitive behavior. If these rules are already in place, why are additional**  
975   **measures needed for the auction?**

976   **A.**   It is important to distinguish between competition in the auction and competition in the  
977           wholesale markets. The competitive safeguards discussed here are in place to ensure a  
978           competitive auction. The participants in the auction access wholesale markets to acquire  
979           components of full-requirements supply, such as capacity and energy. The PJM

980 Interconnection ("PJM") and Midwest Independent Transmission system Organization  
 981 ("MISO") markets are under the jurisdiction of the Federal Energy Regulatory  
 982 Commission ("FERC") and have market monitors that report to the FERC.

983 The competitive safeguards in the auction are aimed at ensuring that the benefits  
 984 from competition that exists in markets for inputs to the auction product – such as  
 985 capacity and energy – and the benefits of competition that exists for providing the price-  
 986 risk manager service and assembling the supply portfolio are actually passed on to  
 987 Ameren's customers through the Auction.

988 **Q. What measures incorporated into the New Jersey BGS auction process would you**  
 989 **consider as competitive safeguards? How do these measures limit anti-competitive**  
 990 **behavior and promote a competitive outcome?**

991 A. The measures that I would consider competitive safeguards are the following.

992 The first safeguard is that the Auction Manager can cut back the volume  
 993 purchased through auction. The Auction Manager would cut back the volume when the  
 994 participation in the auction, while it could be sufficient to obtain supply for the entire  
 995 load, would not be sufficient to ensure a truly competitive bidding environment and a  
 996 competitive result in the auction. In deciding whether to cut back the volume, or in  
 997 determining what the volume should be if it is cut back, the Auction Manager follows a  
 998 set of confidential guidelines approved by the BPU.

999 This measure is a safety net and ensures that, for the portion of the load that will  
 1000 be procured at auction, that prices are the result of competition and are reflective of the  
 1001 market.

1002           **Second**, any volume not procured through the auction (*i.e.*, any volume cutback  
1003 from the auction by the Auction Manager for purposes of ensuring a competitive result)  
1004 would be procured through PJM-administered markets. This second competitive  
1005 safeguard is a necessary complement to the first. Prospective bidders know that their  
1006 only opportunity to serve BGS load is to participate in the auction. This competitive  
1007 safeguard ensures that suppliers do not avoid the auction and, instead, seek to obtain a  
1008 contract to serve BGS load outside of the auction. This ensures that all suppliers who  
1009 want to serve BGS load must come to the auction. This, in turn, ensures that the final  
1010 auction prices are the true result of competition.

1011           **Third**, the New Jersey process includes a load cap, which limits the scope of anti-  
1012 competitive behavior in the auction. A load cap is a limit to the number of tranches that a  
1013 single bidder can bid and win in the auction. The load cap both limits the influence that  
1014 any one bidder can have on the results of the auction and acts as a complement to the  
1015 provisions for volume reduction (the first competitive safeguard). A bidder may be able  
1016 to affect the prices at the auction by withdrawing a portion of its supply. Lowering the  
1017 amount of supply offered by a single bidder weakens the ability of that bidder to  
1018 withdraw the supply profitably. In the extreme, if a bidder has one tranche, the bidder  
1019 cannot withdraw that tranche and profit from withdrawing the supply, as the bidder could  
1020 no longer win at the auction.

1021           The load cap is a complement to the provisions for volume reduction in the sense  
1022 that it limits a bidder's ability to bid in supply at the indicative offer stage or in the first  
1023 round of the auction that over-represents the bidder's interest in the auction. The bidder  
1024 has an incentive to over-represent its interest if the Auction Manager uses indications of

that interest – such as first round bids or indicative offers – in determining whether the auction volume needs to be cut back. By over-representing its interest, the bidder would hope to avoid a volume cutback; once the volume is established at too high a level, a bidder could bid to truly represent its (smaller) interest in the auction. The auction would close faster and at prices higher than those that would have prevailed had the true level of interest been known from the outset. The load cap limits the extent to which each bidder can inflate its interest in the auction and thereby mislead the Auction Manager in setting the volume to be procured.

**Finally**, Association and Confidential Information rules are specified as part of the auction rules that bidders must accept in order to participate in the process. The association and confidential information rules are designed specifically for the auction format to ensure that the scope for anti-competitive behavior is minimized. Association and Confidential Information rules have specific measures that ensure the independence of bidders, that ensure that no bidder has information about its competitors' bids, and that ensure that opportunities for coordination among bidders are minimized. The Association and Confidential Information rules are managed through the qualification process to ensure that bidders that are registered to participate have every incentive to comply. As I mentioned before, violations of some of these rules might also be violation of antitrust laws. For example, if two entities that had registered to bid independently in the auction in fact coordinate their bids, those entities would be violating specific rules of the auction and would be violating their undertakings in the application process – and they might also be violating laws against bid-rigging. Even if some of the rules are redundant in the sense that to violate an auction rule would also mean violating an antitrust, these rules of



1048 the auction would still serve as a focused reminder to auction participants of requirements  
1049 for competitive behavior.

1050 **Q. Is it your understanding that Ameren proposes to include these competitive**  
1051 **safeguards in its process?**

1052 A. Yes, that is my understanding. Ameren proposes to include these same competitive  
1053 safeguards with a view to maximizing the competitiveness of the auction, namely:

- 1054 • provisions for a volume cutback to promote a competitive outcome in each segment  
1055 of the auction;
- 1056 • a contingency plan in case of volume cutback that appropriately ensures that bidders  
1057 do not have an opportunity to contract with Ameren to serve BGS load except  
1058 through the auction;
- 1059 • a load cap in each auction segment to limit the influence of any one bidder;
- 1060 • Associations and Confidential Information rules to minimize the scope for anti-  
1061 competitive behavior in each segment of the Ameren auction.

1062 **Q. Can you elaborate on Ameren's proposal for a volume cutback?**

1063 A. The Competitive Procurement Auction Rules filed in this proceeding provide to the  
1064 Auction Manager the ability to cut back the volume purchased if this is necessary to  
1065 ensure a competitive bidding environment. The decision on whether to cut back the  
1066 volume is to be made separately for each segment of the auction (the Fixed Pricing  
1067 segment and the Spot Market segment) because qualifications and bids are made  
1068 separately for each segment. This means that it would be possible for the volume in the  
1069 Spot Market Segment to be reduced while the Fixed Pricing segment proceeded at full  
1070 volume or vice-versa. The Auction Manager would use guidelines to assess whether the

1071 volume in a segment must be reduced and to calculate the magnitude of the volume  
1072 reduction, if any. To avoid possible gaming by bidders that could undermine the  
1073 effectiveness of the safeguard, the exact algorithms and method that the Auction Manager  
1074 uses should be kept confidential. For example, if bidders knew that the guidelines to  
1075 determine the volume in a segment relied solely on the bids in the first round, bidders  
1076 may have an incentive to over-represent their interest in the first round to avoid a volume  
1077 cutback that would otherwise have been necessary to get a competitive results.

1078 **Q. What is your understanding of Ameren's proposal for a contingency plan?**

1079 A. For any volume not procured through the auction (for example, any volume cutback from  
1080 the Fixed Pricing segment by the Auction Manager for purposes of ensuring a  
1081 competitive result), Ameren's contingency plan specifies that any such volume would be  
1082 procured through MISO-administered markets. This properly ensures that suppliers do  
1083 not have an opportunity to obtain a contract to serve BGS-FP, BGS-LFP, or BGS-LRTP  
1084 load outside of their participation in the auction.

1085 **Q. What is your understanding of Ameren's proposal regarding the load cap?**

1086 A. Ameren is proposing that each segment of the auction be subject to a 50% load cap. A  
1087 bidder in the Spot Market segment could bid or win no more than 50% of the tranches of  
1088 BGS-LRTP load, the only product in the Spot Market segment. A bidder in the Fixed  
1089 Pricing segment would be limited to 50% of the tranches in the segment, but a bidder  
1090 would not be limited to 50% for a given product. For example, if there were 80 tranches  
1091 in the Fixed Pricing segment, and 25 of those tranches were tranches of BGS-LFP load, a  
1092 bidder could bid for and win all 25 tranches of BGS-LFP load. Although the bidder  
1093 would be bidding on 100% of a given product (*i.e.*, BGS-LFP load) the bidder would

1094 only be bidding on  $25/80 = 31.25\%$  of the tranches for the segment in which the product  
1095 resides (*i.e.*, the Fixed Pricing segment).

1096 **Q. Is a load cap by segment appropriate given the design of the auction as proposed by**  
1097 **Ameren?**

1098 A. Yes, I believe a load cap by segment is the appropriate choice given the design of the  
1099 auction.

1100 In the auction proposed by Ameren, bidder qualification is separate for each  
1101 segment. Bidder qualification is undertaken for all bidders concurrently, but a bidder that  
1102 wishes to bid in both segments must qualify separately for each segment of the auction.  
1103 Similarly, bids on both segments are submitted simultaneously, but separately. A bidder  
1104 who has registered to bid for both segments of the auction submits a separate number of  
1105 tranches for each product of each segment, and the bidder cannot switch tranches from  
1106 one segment to the other. A bidder who has registered to bid for one segment only can  
1107 only bid for that segment. Bidders are provided for information regarding the total excess  
1108 supply for each segment separately. Bidding on each segment will typically end at  
1109 different time.

1110 A load cap by segment, which appropriately limits the influence that any one  
1111 bidder can have on the results of a segment, is consistent with the design of the auction.  
1112 A load cap for the entire auction is not appropriate, as bidders cannot switch among all  
1113 products. The New Jersey fixed price auction uses a load cap for each utility whose load  
1114 is at auction and it ensures that each utility has a diversified base of suppliers. This  
1115 rationale does not apply to the Ameren auction so that a load cap by product is not  
1116 necessary.

1117 **Q. Can the load cap proposed by Ameren be expected to appropriately limit the scope**  
1118 **for anti-competitive behavior in the Fixed Pricing segment?**

1119 A. In my opinion, the load cap proposed by Ameren can be expected to appropriately limit  
1120 the scope for anti-competitive behavior in the auction.

1121 As I stated earlier when examining the need for competitive safeguards, a load  
1122 cap should limit a bidder's ability to bid in supply at the indicative offer stage or in the  
1123 first round of the auction that over-represents the bidder's interest in the auction. In my  
1124 opinion, the load cap proposed by Ameren would provide discipline on a bidder's ability  
1125 to over-represent its interest in the auction.

1126 A load cap of 50% would mean that, in the Fixed Pricing segment, there would be  
1127 a limit of 40 tranches that a bidder could bid and win in the first auction. In subsequent  
1128 auctions, there would a limit of roughly 22 tranches that a bidder could bid and win since  
1129 one-third of the BGS-FP load (approximately 18 tranches) and the totality of the BGS-  
1130 LFP load (approximately 25 tranches) would be at auction. In my opinion, these limits  
1131 would be unlikely to constrain the participation of marketers and financial players that  
1132 form the bulk of the anticipated bidding pool. These entities, in my opinion, are unlikely  
1133 to have business plans that would incorporate exposure to fixed-price products in excess  
1134 of these amounts. To the extent that some of these entities would wish to participate at  
1135 lower levels, particularly in the first year, this load cap may not completely eliminate  
1136 these entities' ability to over-represent their interest; however, I believe that a load cap at  
1137 this level would impose the needed discipline on a bidder's ability to do so. This  
1138 discipline means that the Auction Manager is likely to set the volume in the Fixed Pricing  
1139 segment on the basis of reasonably reliable information.

As I stated earlier, competitive safeguards are needed in part to curb the influence that any one bidder can have on the results of the auction. Competitive safeguards can serve to limit a bidder's ability to withdraw tranches profitably, which in turn prevents the bidder from closing the auction unilaterally at prices higher than would otherwise have been the case. There are potentially two instruments that can be used to limit a bidder's ability to withdraw tranches profitably. The first instrument is the load cap: lowering the amount of supply offered by a single bidder lowers the profitability of withdrawing supply. In the extreme, if a bidder bids a single tranche, the bidder cannot withdraw that tranche and profit from doing so, as the bidder could no longer win at the auction. The second instrument is the information provided to bidders: restricting information regarding excess supply in the auction means that the benefit – and therefore the profitability – of withdrawing tranches becomes uncertain. However, restricting information in this way can also hamper the ability of bidders to learn and revise their bids on the basis of market information, which is one of the key benefits of an open auction format. Bidders in a clock auction will rely on the fact that they are provided with information that relates the going prices to the amount of excess supply in the segment.

In my opinion, the combination proposed by Ameren of a 50% load cap together with limiting information regarding the remaining excess supply in each segment but only when bidding nears its conclusion strikes the right balance. This combination should be effective in limiting the influence of a bidder or a small group of bidders on the auction results while providing information to bidders on a round-to-round basis to enable bidders to revise their bids and learn on the basis of the information available to them.